

Attracting FDI to the Western Balkans:

Does government support for Special Economic Zones inhibit smart specialisation?

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Outline

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SEZs in the Western Balkans



Defining Special Economic Zones

- **Free zones**

- Trade orientation with customs provisions
- Early developments in 1990s

- **Industrial zones**

- Developed by municipalities
- Local production
- No customs provisions

- **Export processing zones (EPZs)**

- Special conditions for processing companies engaged in production for exports
- Exemptions from customs, VAT and other taxes

Laws on SEZs

- SEZ laws permit export processing activity (EPZ)
- Early adopters
 - Serbia (2006)
 - Macedonia (2007)
 - Bosnia (2009)
- More recent initiatives
 - Albania (2015)
 - Montenegro (2016)
 - Federation of Bosnia and Herzegovina (2016)

Inventory of Export Processing Zones

Country	Name of EPZ
Albania	“Technology and Economic Development Areas” (none active)
Bosnia	“Free Zones” (4 active EPZs)
Kosovo	“Industrial Zones” (no EPZs)
Macedonia	“Technological Industrial Development Zones (8 active EPZs)
Montenegro	“Strategic Business Zones” (5 EPZs planned)
Serbia	“Free Zones” (14 active EPZs)

Approaches to SEZs

- Two designs: centralised vs. decentralised
 - Centralised design allows strategic location and investment in infrastructure
 - Macedonia – “TIDZs”
 - Decentralised design allows responsiveness to local needs
 - Serbia & Bosnia – “Free Zones”
- Other countries in the region are looking at examples to decide which way to go

Former Yugoslav Republic of Macedonia

- “Directorate for Technology Industrial Development Zones” manages the process
 - TIDZ are under state ownership
- Subsidies to attract high tech FDI companies:
 - 0% customs duties or VAT on imported goods or equipment (vs. standard 18%)
 - 0% profit tax for up to 10 years (vs. standard 10%)
 - Subsidies to build a factory up to €500,000
 - Employment subsidies up to 50% gross wage, and 50% of justified investment costs up to €50 million
- 8 active “TIDZs” with 18 active users

Serbia

- Law on Free Zones 2006 defines Free Zone as export processing zone
- Bottom-up approach, driven by municipalities, under regulation of the Free Zone Administration
 - FZs usually owned by the municipalities
- Subsidies to attract FDI companies to FZs:
 - 0% customs duties, VAT on goods or equipment (vs. 20%)
 - 0% excise duty on electricity supply
- Subsidies to FDI companies in general
 - 0% profit tax for 10 years if invest >€8m and employ > 100 workers (inside or outside FZ) (vs. standard 15%)
 - Investment subsidies (inside or outside FZs) depending on level of municipal development, investment size, number of jobs created
- 14 FZs host 240 companies

Investment and productivity



High cost of job subsidies (Serbian example)

- Investors negotiate non-transparent agreements with RAS
 - average subsidy of €9,000 per job created in 2014, and €5,000 in 2016
 - Similar to investment per employee in SEZs (2015 €7,000)
 - The cost of the programme was €45 million in 2014 and had increased to €85 million by 2016.
- The subsidies granted are almost equivalent to the investment per employee in FZs
- State aid should conform to state aid rules and regional aid guidelines
- In particular, state aid should be transparent and in line with regional development plans
 - Only for initial investments
 - Not exceed permitted aid intensities
 - Should be temporary

Productivity in Serbian FZs

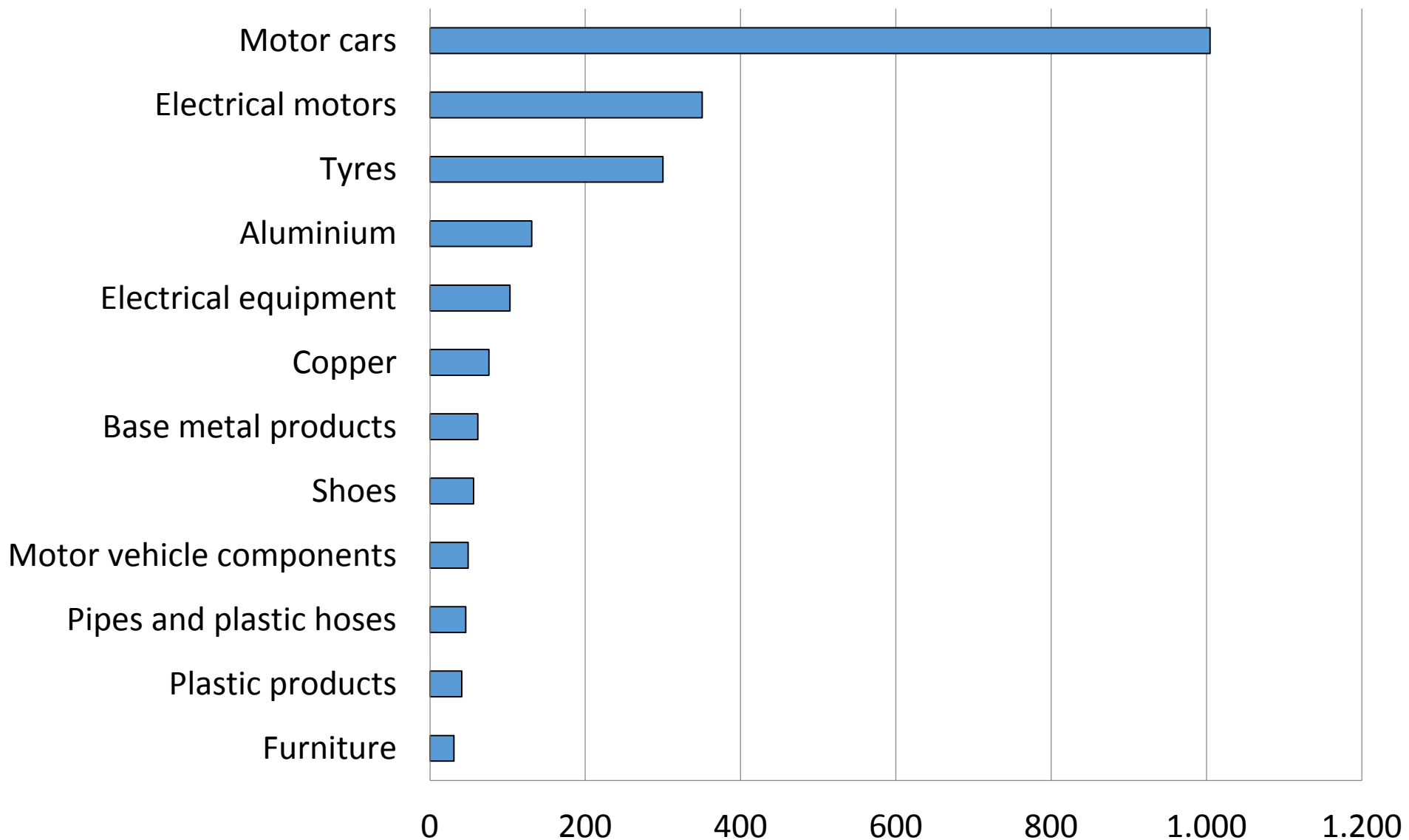
		2012	2013	2014	2015
Gross value added per employee (€)	(A) With Kragujevac	-26,794	24,644	24,501	25,893
	(B) Without Kragujevac	13,786	13,874	12,192	16,636

Productivity by size group

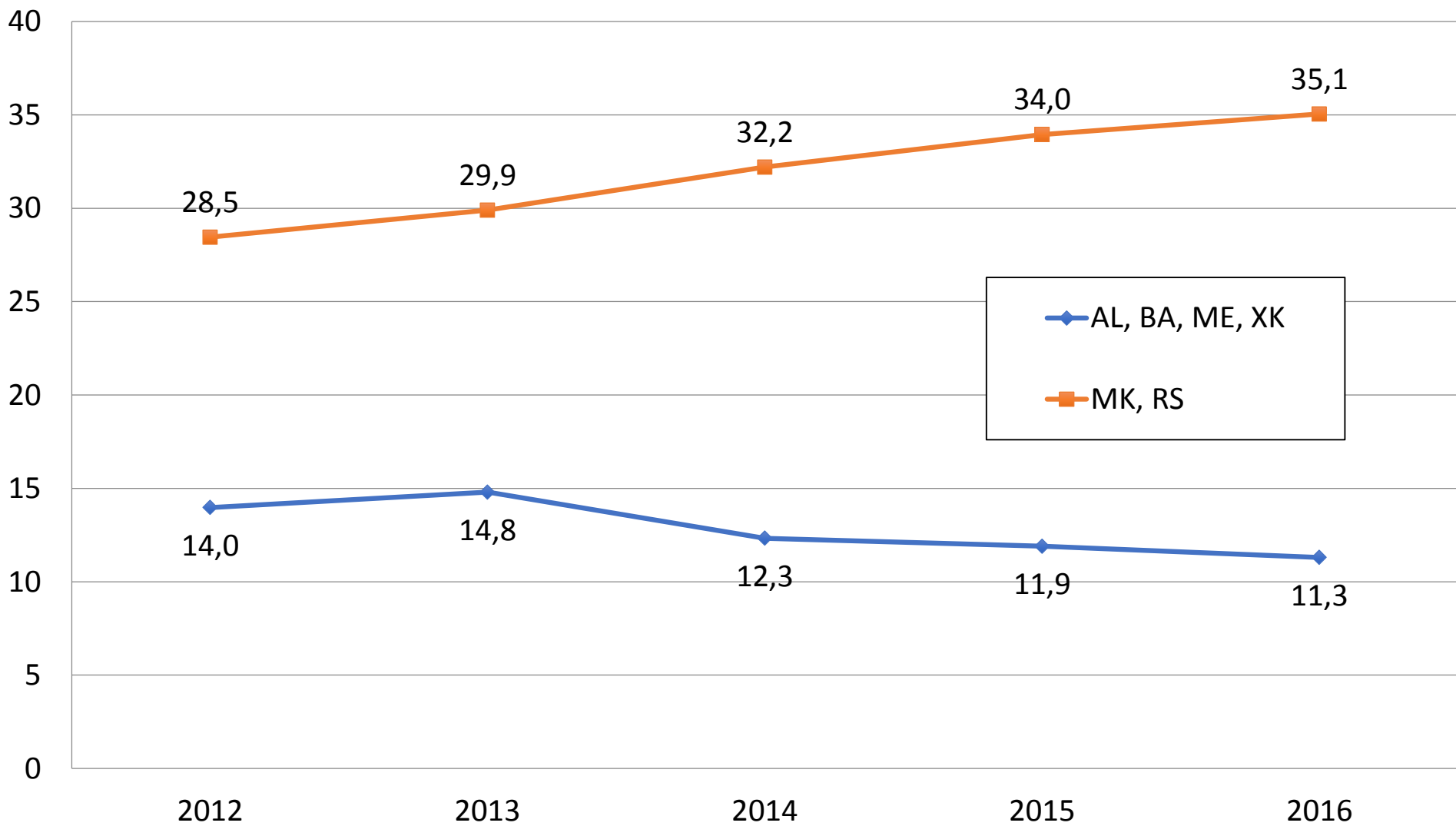
- Value of output per employee in FZs is inversely related to the size of the companies they host
 - €199,000 in SEZs with small companies
 - €97,000 in SEZs with large companies
- Employment subsidies may have had a perverse effect of encouraging large companies to employ too many “surplus” workers, thus reducing productivity

EXPORTS

Exports from Serbian FZs by broad product group, 2016 (€m)



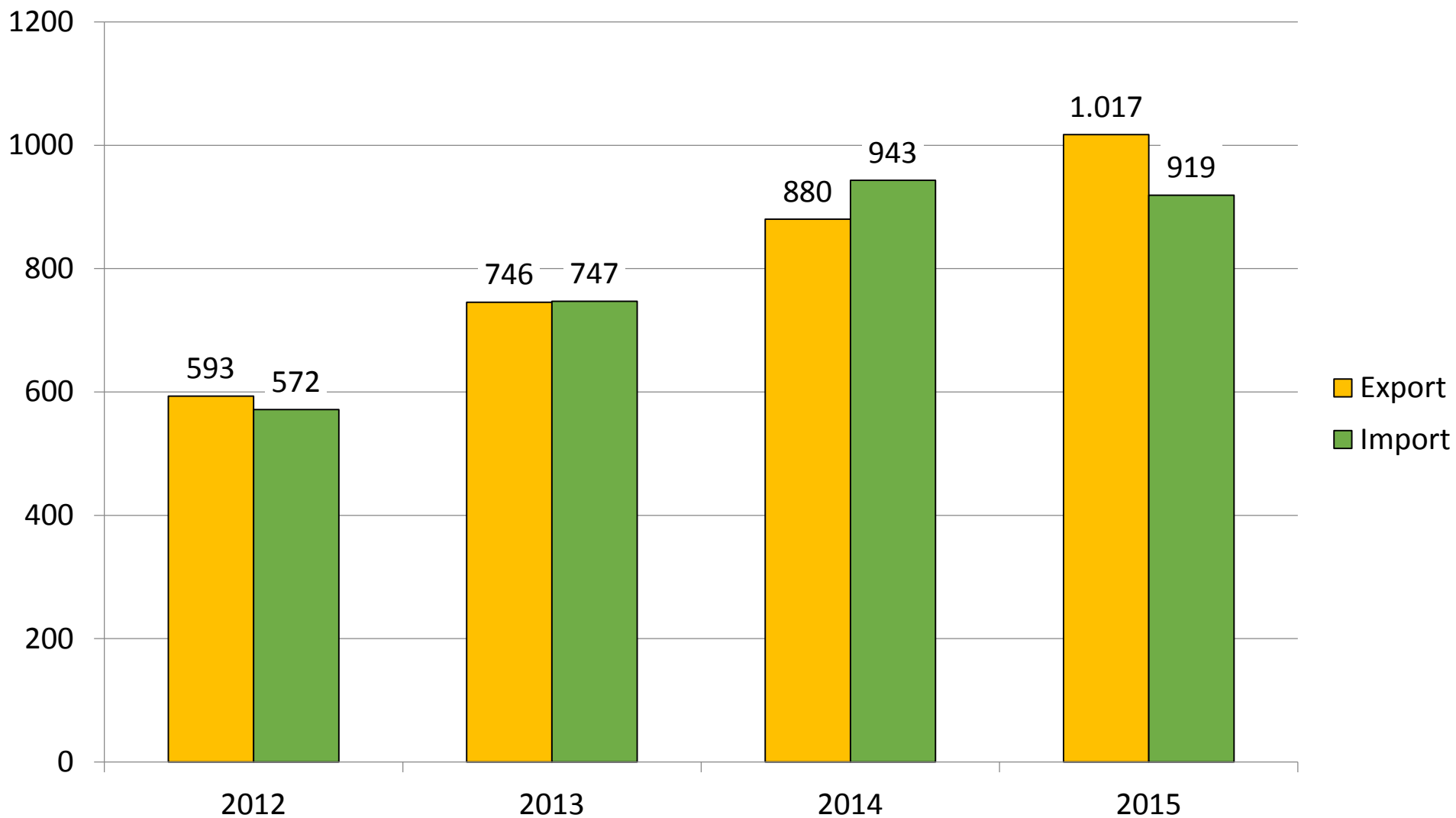
Goods exports (% GDP)



Improved trade performance

- In Macedonia, exports from TIDZ account for 35% of total exports (2016)
 - One company, Johnson Mathey, in “Skopje 1” TIDZ accounts for 16.4% of total exports
- Exports grew by 40% from 2013-2016.
- In both Macedonia and Serbia, the import content of exports from SEZ is extremely high
 - Around 80% - 100%
 - Indicates little impact on local economic development

Exports and imports Serbian FZs, (non-Kragujevac) (€m)

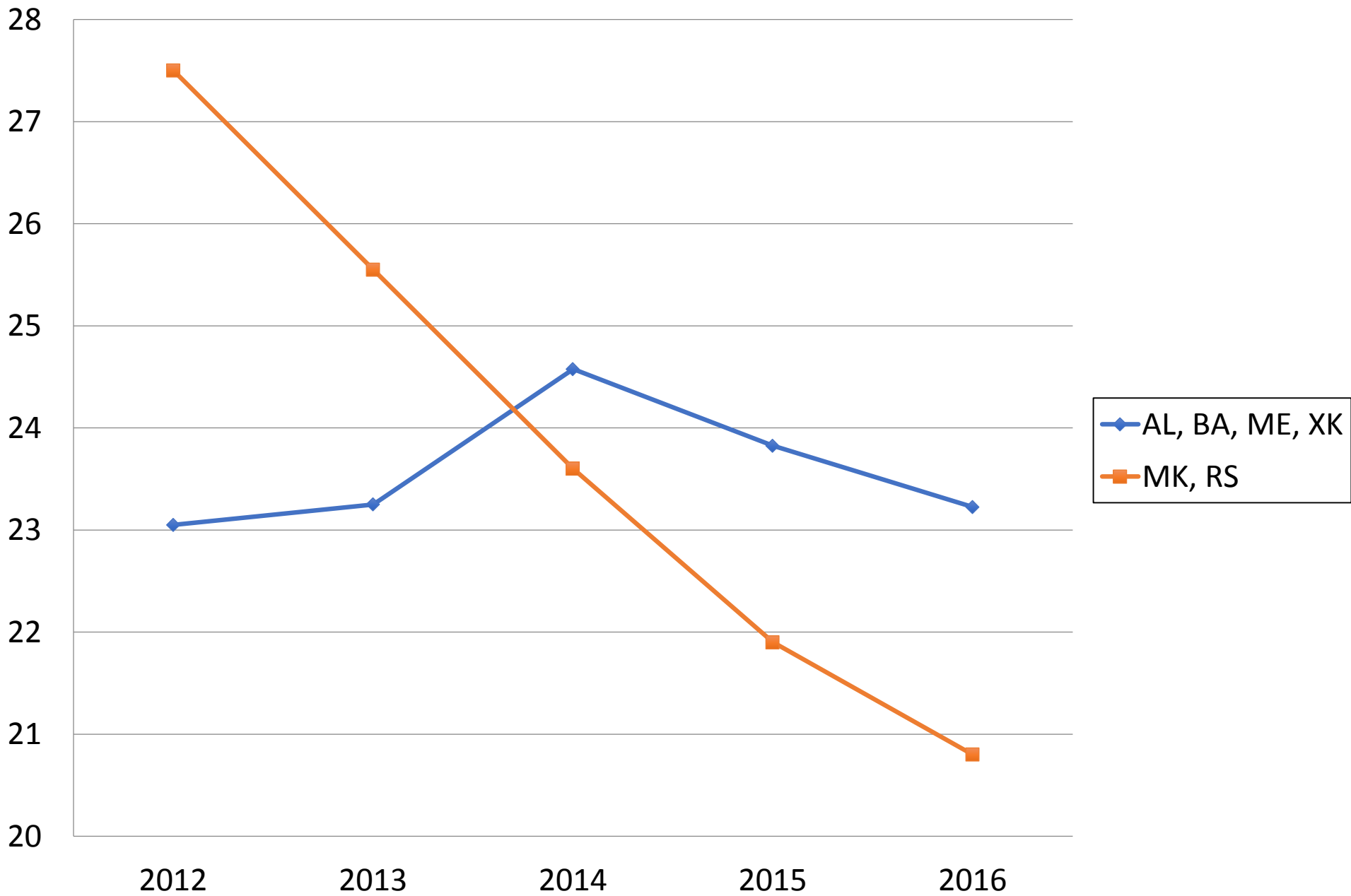


EMPLOYMENT

Direct and indirect employment effect of SEZs

- **Direct effects** have been strong in Serbia
 - FZ jobs increased from 14,500 in 2012 to 25,000 in 2016
 - FZ jobs increased 5 times faster than in the whole economy
- In Serbia, for every job created by FDI, about 4 to 7 jobs are **indirectly created** in the local economy (RAS estimate)
 - Though this doesn't take into account displacement and deadweight effects, so is an upper estimate
- We estimate that between 25% and 50% of all jobs created in last few years have been due to direct and indirect effect of SEZs

Unemployment rate (%)



SEZs and the local economy



Use of local resources and suppliers

- Use of local suppliers varies between SEZs
 - In Macedonia – 500 local companies supply TIDZs
 - In Serbia – supply chain is virtually non-existent
 - In Bosnia – largest FZ Visoko, only 4% supplies sourced locally
- Large technology gaps often inhibit use of local suppliers

Technology transfer

- In Macedonia there is some technology transfer is in evidence.
 - Example of Aktiva, which invested €7m to produce components for Van Hool and has bought a robotic welding machine
- In Serbia there are few examples of technology transfer

Workforce skills and local schools

- In Macedonia there is a shortage of skilled workers in localities around larger TIDZs
 - Risk that pool of skilled labour will quickly become exhausted
 - Upward pressure of wages for skilled workers
 - TIDZ companies sending employees abroad for training
- In Serbia there is a similar picture of emerging skill gaps
 - Some companies cooperate with local vocational schools to modernise curricula
 - GIZ project on dual education: first batch of graduates all found jobs with Bosch

Conclusions



Impact of SEZs

- Attracts investment
 - But at **high cost in subsidies**
- Some evidence of **improvement in productivity, employment, exports**
 - But, **little evidence of spill-over to local economy**
- **Governments seem to be using FDI subsidies as alternative to regional development policy based on smart specialisation**
 - May be related to greater opportunities for **rent-seeking** in centralised subsidy system compared to decentralised transparent actor mobilisation under 3S strategy

Conclusion – Smart specialisation

- In order to embed FDI within SEZs into local economies, smart specialisation strategies are needed to **leverage impact of SEZs to local economies**
- This should involve
 - Upgrading the technological level of local suppliers (give fiscal support to local SMEs not large foreign investors)
 - Vocational education modernisation and reform
 - Expansion of state expenditure on retraining of unemployed workers

Thank you for your attention
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